

# China Eastern Airlines (670.HK)



Phillip Securities (HK) Ltd  
Phillip Securities Research

## Still facing headwind

Bloomberg | Reuters | POEMS

670.HK | 670.HK | 670.HK

Industry: Airlines

2 October 2013

### 2013H Result Review

Rating: Accumulate CP:2.54HKD TP:2.71HKD

#### Company Profile

China Eastern Airlines (CEA) is one of China's Big-3 Carriers and a member of the SkyTeam. CSA owns 433 Boeing and Airbus planes currently. With the headquarters located in Shanghai, CEA listed in HKEx (670.HK) and SSE (600115.SH) in 1997.

#### Summary

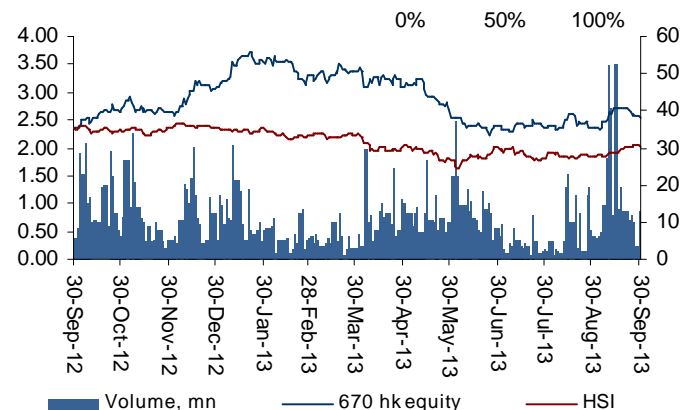
- In 1H2013, CEA's revenue increased slightly by 2.9% y-y to RMB42.276 billion with net profit of RMB622 million, down 28.2% y-y. The main reason of the decrease of the performance is because of the slow-down of profit growth and slight increase of costs. The EPS recorded RMB0.054, compared with RMB0.077 during the same period of last year. The Company purchased 20 passenger aircraft, and operated a total of 433 aircrafts.

- Due to the changes of customer structure (business passengers reduced and the traveling passengers increased), the weak demand of Japan routes and the passenger load factor was affected by the avian influenza in April and May, together with the passengers' preference for High-speed railway over airline transportation becoming more common and the continued downturn of the freight transport market, the level of the prosperity of airline industry was lower than the expectation in 1H2013, but the transport capability still experienced larger increase relatively, which caused the ticket price maintained on the bottom in the long term because of the more intense industry competition, and the Company's profitability declined seriously due to the large pressure of yield, although the passenger load factor stayed at the stable level. Based on the year-on-year growth rates of 12.2% and 9.2% in passenger turnover and the amount of passengers, passenger revenues only increase by 3.3%. The yield of passenger/k recorded RMB0.6, down 9% from RMB0.65 during the same period of last year. Due to the strategy of "Decreased price to protect the volume", the passenger load factor increased slightly by 0.24ppts to 79.3%.

- Due to the continued downturn of global air freight market, CEA's freight carried and revenues decreased by 3% and 11.8% y-y in 1H2013. Freight load factor dropped 1.9ppts y-y to 59.9%. Freight tone/km yield amounted to RMB1.54, down 13% largely y-y from RMB1.77 in 1H2012.

#### CEA

<b>Rating</b>	<b>2.00</b>	<b>Accumulate</b>
- Previous Rating	2.00	Accumulate
<b>Target Price (HKD)</b>	<b>2.71</b>	
- Previous Target Price (HKD)	3.73	
Closing Price (HKD)	2.54	
Expected Capital Gains (%)	6.7%	
Expected Dividend Yield (%)	0.0%	
<b>Expected Total Return (%)</b>	<b>6.7%</b>	
Raw Beta (Past 2yrs weekly data)	1.20	
Market Cap. (HKD bn)	42,127	
Enterprise Value (HKD mn)	98,891	
52 week range (HKD)	2.19 - 3.73	
Closing Price in 52 week range		



#### Key Financial Summary

FYE	12/12	12/13F	12/14F	12/15F
Revenue (RMB mn)	85,253	93,674	103,126	113,936
Net Profit, adj. (RMB mn)	2,954	2,584	3,603	4,960
EPS, adj. (RMB)	0.26	0.22	0.31	0.43
P/E (X),adj.	7.8	9.0	6.5	4.7
BVPS (RMB)	2.03	2.21	2.63	2.89
P/B (X)	1.0	0.9	0.8	0.7
DPS (RMB)	0.00	0.00	0.00	0.02
Div. Yield (%)	0.0%	0.0%	0.0%	1.0%

Source: Bloomberg, PSR est.

\*All multiples & yields based on current market price

#### Valuation Method

PE & PB

#### Research Analyst

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- Operating expenses of the Company increased by 7.4% y-y to RMB42.14 billion in total, especially for the significantly growth of indirect operating and other costs with the total amount of RMB5.19 billion, up 27.7% y-y to RMB1.13 billion, mainly caused by the increase of costs due to the business expansion of the Company's subsidiaries. Additionally, the costs of D&A and fuel increased by RMB330 million (+9.1%) and RMB310 million (+2.1%) respectively compared with the same period of last year. The Company's fuel cost amounted to RMB14.978 billion, around 35.5% of total operating expenses, and the consumption of fuel increased by 11% and average oil price dropped 9.2% y-y.

- Benefited from the RMB appreciation, the Company's foreign exchange gains amounted to RMB1.174 billion, up RMB1.4 billion y-y, and eased the pressure of its main business (the Company's main businesses only gained the profits of RMB135 million, much lower than RMB1.85 billion of last year), which became the main profit resource. However, the appreciation of RMB has slowed down after 1H, and we expect exchange gains will decrease obviously in 2H compared with that of 1H

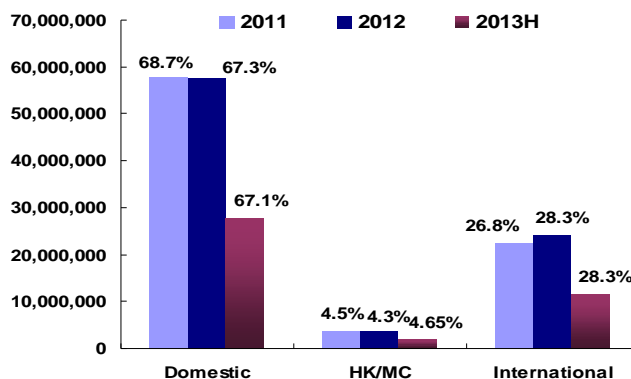
- Outlook: The industry will face the boom season in 2H, although the demand of traveling passengers abroad maintained two-digit growth, the supply and demand of the industry and the price level did not improved obviously because of the weather in July and Aug and non-efficient recovery of the industry demand/supply and ticker price, we expect the boom season of aircraft demand will be delayed to the late September. Additionally, the ex factory price of aviation fuel increased continually to RMB400/ton accumulatively since July. In all, the Company's profits would be improved in 2H compared with 1H, but face the downturn pressure compared with the same period of last year

- Valuation:** We adjust the EPS of the Company to RMB0.22/0.31/0.43 in 2013/2014/2015 respectively. We cut the 12-month target price to HK\$2.71, equivalent to 9.0/6.5/4.7xP/E and 0.9/0.8/0.7xP/B in 2013/2014/2015 respectively. Located in Shanghai, the Company would be benefited from the establishment and promotion of Shanghai Disney and Shanghai Free Trade Zone (FTZ) in future, so recommend cautiously Accumulate rating.

**Risk**

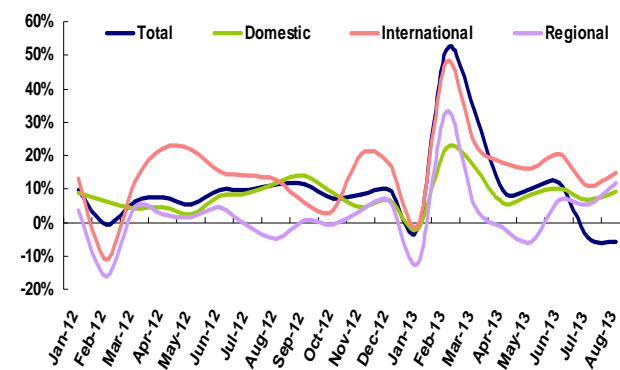
- Economic recession dampens transportation demand;
- Crude oil prices fluctuate violently;
- RMB depreciation causes foreign exchange loss;
- War, terrorist attacks, pandemic and other emergencies;
- Competition through price-cuts may accelerate;
- High-speed railway competitions

**Fig 1. Regional routes account more**



Source: Company reports, PSR

**Fig 2. RPK growth of CEA**



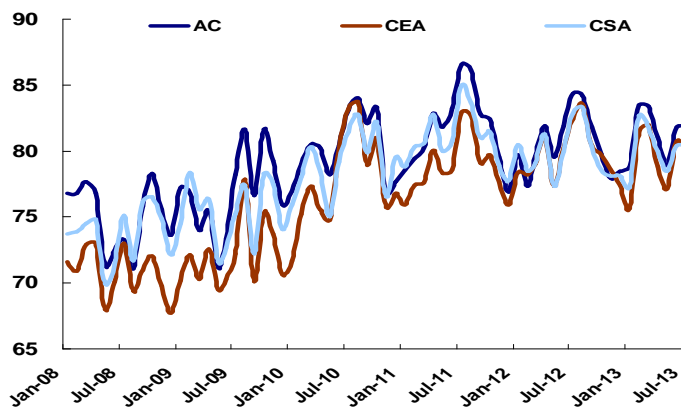
Source: Company reports, PSR

**Fig 3. Fleet Delivery Plan**

	2H2013		2014		2015	
	New delivery	Disposal	New delivery	Disposal	New delivery	Disposal
Narrow-body aircraft	33	9	58	28	61	25
Wide-body aircraft	5		12	2	12	4
Freighters		3		1		1
<b>Total</b>	<b>38</b>	<b>12</b>	<b>70</b>	<b>31</b>	<b>73</b>	<b>30</b>

Source: Company reports, PSR

**Fig 4. P L/F (Passenger Load Factor) Comparison**



Source: Company reports, PSR

Fig 5. Fleet Delivery Plan

(RMB million)

Items	1H2013	2H2013E
Expenditure on aircraft	7,927	13,958
Other capital expenditures	2,051	2,333
<b>Total</b>	<b>9,978</b>	<b>16,291</b>

Source: Company reports, PSR

Fig 6. Peer Valuation Comparison

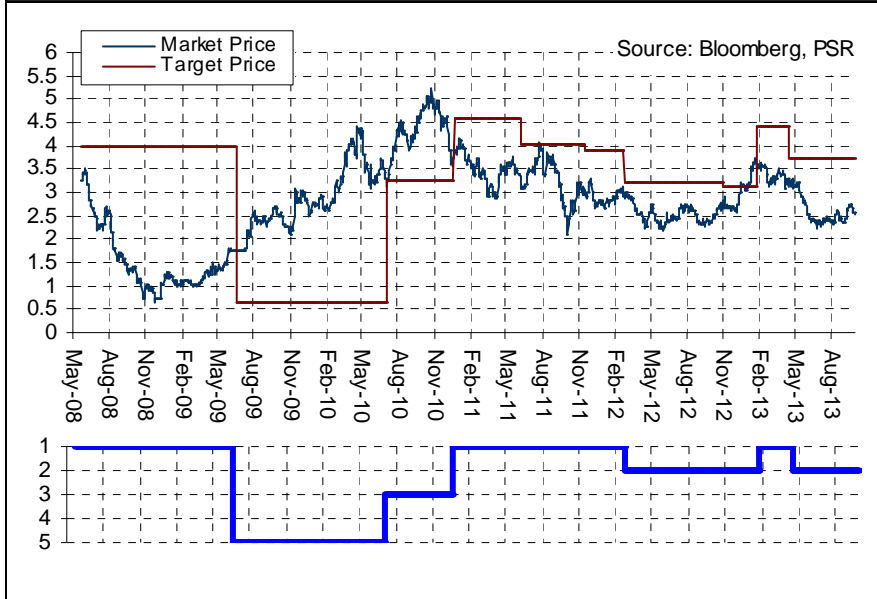
Name	Ticker	Cap: USD Mil	BEst P/B	BEst P/B: Y+1	BEst P/E	BEst P/E: Y+1	BEst EV/BEst EBITDA	P/B	ROA LF%	ROE %
VIRGIN AUSTRALIA HOLDINGS LT	VAH AU	1039	1.1	1.1	43.0	16.5	7.4	1.1	-2.3	-10.0
AIR CANADA-CLASS A	ACA CN	978	N/A	N/A	7.9	4.3	2.5	N/A	1.6	N/A
AIR CHINA LTD-A	601111 CH	8712	0.9	0.9	9.2	8.5	7.2	1.1	2.6	9.6
CHINA EASTERN AIRLINES CO-A	600115 CH	5432	1.3	1.2	9.6	8.4	8.5	1.0	2.2	13.7
HAINAN AIRLINES CO-A	600221 CH	4091	N/A	N/A	10.2	9.0	N/A	1.3	2.3	10.1
DEUTSCHE LUFTHANSA-REG	LHA GR	8909	1.0	0.9	13.2	8.4	2.8	1.3	3.2	12.2
AIR FRANCE-KLM	AF FP	2954	0.6	0.5	N/A	9.3	5.1	0.8	-2.6	-21.7
RYANAIR HOLDINGS PLC	RYA ID	12134	2.5	2.3	15.1	12.7	8.2	2.9	6.0	17.3
INTL CONSOLIDATED AIRLINE-DI	IAG LN	10863	2.1	1.8	31.1	12.0	5.4	3.5	-5.7	-18.6
EASYJET PLC	EZJ LN	8128	2.5	2.2	13.8	12.2	7.5	3.0	6.7	14.6
CHINA EASTERN AIRLINES CO-H	670 HK	5432	0.9	0.8	8.5	7.8	8.7	1.0	2.2	13.7
AIR CHINA LTD-H	753 HK	8713	1.0	0.9	12.4	10.2	8.2	1.1	2.6	9.6
CATHAY PACIFIC AIRWAYS	293 HK	7711	1.0	1.0	24.9	13.4	8.4	1.0	1.2	1.6
CHINA SOUTHERN AIRLINES CO-H	1055 HK	4276	0.6	0.6	11.5	8.4	8.4	0.7	1.8	8.1
JET AIRWAYS INDIA LTD	JETIN IN	495	N/A	N/A	N/A	15.2	11.8	N/A	-4.0	N/A
ANA HOLDINGS INC	9202 JP	7692	1.0	0.9	18.4	15.3	5.1	1.0	1.7	6.6
KOREAN AIR LINES CO LTD	003490 KS	2064	1.0	0.9	N/A	N/A	9.2	0.8	1.1	9.8
ASIANA AIRLINES	020560 KS	931	1.1	1.1	N/A	62.9	12.1	1.0	1.0	6.6
AIRASIA BHD	AIRA MK	2183	1.2	1.1	9.6	8.2	8.0	1.6	4.3	36.9
MALAYSIAN AIRLINE SYSTEM BHD	MAS MK	1716	1.1	1.2	N/A	N/A	14.6	1.2	-1.9	-27.3
SINGAPORE AIRLINES LTD	SIA SP	9755	0.9	0.9	21.3	16.7	3.4	0.9	1.9	2.9
THAI AIRWAYS INTERNATIONAL	THAI TB	1388	0.6	0.6	13.5	8.3	6.2	0.6	1.3	9.5
CHINA AIRLINES LTD	2610 TT	1952	1.1	1.0	17.0	9.8	11.6	1.1	-0.1	0.1
EVA AIRWAYS CORP	2618 TT	1852	1.4	1.4	28.6	14.8	9.0	1.6	0.2	1.4
DELTA AIR LINES INC	DAL US	20222	N/A	9.2	8.4	8.1	5.8	N/A	3.9	N/A
UNITED CONTINENTAL HOLDINGS	UAL US	11001	7.7	3.3	11.2	6.9	4.9	9.0	-1.5	-63.2
SOUTHWEST AIRLINES CO	LUV US	10339	1.5	1.4	15.1	12.6	4.7	1.5	2.0	6.1

Source: Bloomberg, PSR

FYE DEC	FY10	FY11	FY12	FY13F	FY14F	FY15F
<b>Valuation Ratios</b>						
P/E (X), adj.	4.7	5.1	7.8	9.0	6.5	4.7
P/B (X)	1.5	1.2	1.0	0.9	0.8	0.7
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	1.0%
<b>Per share data (RMB)</b>						
EPS, reported	0.44	0.41	0.26	0.22	0.31	0.43
EPS, adj.	0.44	0.41	0.26	0.22	0.31	0.43
DPS	0.00	0.00	0.00	0.00	0.00	0.02
BVPS	1.35	1.79	2.03	2.21	2.63	2.89
<b>Growth &amp; Margins (%)</b>						
<b>Growth</b>						
Revenue	84.9%	12.1%	2.1%	9.9%	10.1%	10.5%
EBIT	220.5%	-25.8%	1.9%	-39.1%	81.8%	35.6%
Net Income, adj.	2837.8%	-7.7%	-35.4%	-12.5%	39.5%	37.7%
<b>Margins</b>						
EBIT margin	6.8%	6.5%	2.0%	2.5%	2.8%	3.7%
Net Profit Margin	6.7%	5.5%	3.5%	2.8%	3.5%	4.4%
<b>Key Ratios</b>						
ROE (%)	60.1%	25.9%	13.7%	10.6%	12.9%	15.6%
ROA (%)	5.7%	4.2%	2.5%	2.0%	2.6%	3.2%
<b>Income Statement (RMB mn)</b>						
Revenue	74,462	83,465	85,253	93,674	103,126	113,936
Operating expenses	(68,765)	(79,292)	(82,745)	(92,324)	(99,665)	(108,845)
Profit from operations	5,697	4,173	4,228	2,642	4,780	6,459
Non-operating income/expense	67	106	133	12	45	84
Profit before tax	5,418	4,841	3,012	2,505	3,870	5,356
Tax	(133)	(264)	(205)	(108)	(186)	(289)
Profit for the period	5,284	4,576	2,808	2,397	3,684	5,066
Minority interests	(326)	(1)	146	187	(81)	(106)
Total capital share	11,257	11,257	11,277	11,603	11,603	11,603
<b>Net profit</b>	<b>4,958</b>	<b>4,576</b>	<b>2,954</b>	<b>2,584</b>	<b>3,603</b>	<b>4,960</b>

Source: PSR

**Ratings History**



**PSR Rating System**

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
< -20%	Sell	5

**Remarks**

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PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm$ 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

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